

State and Local Taxation

by

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Abstract

State and local taxation comprises those taxes that are collected at the sub-federal government levels in order to finance state and local public services, assigning some discretion in the determination of rates and bases of these taxes to sub-federal governments. The existence of state and local taxes is explainable by the geographical incidence of public services within a federation. In order not to provide wrong incentives for free riding, each individual should pay for the public services consumed and decide on the level of provision. Thus, state and local taxes are imposed to finance state and local public services. Because federal, state and local taxes already exist, guidelines for the assignment of different taxes to different government levels are necessary. These guidelines are derived by considering different forms of inter-jurisdictional externalities. Actual tax systems in OECD countries do however not necessarily follow these guidelines of optimal sub-federal taxation. Since these tax systems are not merely the outcome of historical incidents, political and institutional factors add to the positive understanding which kinds of taxes are used by sub-federal jurisdictions.

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